

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Statutory Review of the System  
for Regulating Rates and Classes  
for Market Dominant Products

Docket No. RM2017-3

MOTION BY THE PUBLIC REPRESENTATIVE FOR RECONSIDERATION

(January 5, 2018)

Pursuant to Rule 21 of the Commission's Rules of Practice and Procedure, 39 C.F.R. § 3001.21, the Public Representative hereby moves for reconsideration of the Commission's determination in Order No. 4257 that short-term financial stability has been maintained under the market dominant rate and classification system.<sup>1</sup>

I. INTRODUCTION

On December 1, 2017, the Commission issued Order No. 4257 in which it reviewed the existing market dominant rate and classification system (market dominant system) to determine whether the system is achieving the objectives of 39 U.S.C. § 3622(b) taking into account the factors in 39 U.S.C. § 3622(c). The Commission found that the market dominant system as a whole has not achieved the objectives of the Postal Accountability and Enhancement Act (PAEA). Order No. 4257 at 275.

In a companion order, Order No. 4258, the Commission initiated a rulemaking proceeding "to propose such modifications to existing regulations or adopt such an alternative system through new regulations that the Commission deems necessary to achieve the objectives of 39 U.S.C. § 3622(b)."<sup>2</sup> The Commission's proposals are based upon its findings in Order No. 4257.<sup>3</sup>

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<sup>1</sup> Order on the Findings and Determination of the 39 U.S.C. § 3622 Review, December 1, 2017, at 165 (Order No. 4257).

<sup>2</sup> Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017, at 2 (Order No. 4258).

## II. ORDER NO. 4257

### A. The Framework Used to Determine Whether Statutory Objectives Are Being Achieved

In Order No. 4257, the Commission adopted a topical approach to analyze whether section 3622's objectives had been met. Order No. 4257 at 22. Using that approach, the Commission identified three principal topics: the structure of the ratemaking system, financial health of the Postal Service, and service. *Id.* Each of these topics was further divided into major subtopics.<sup>4</sup> The Commission then analyzed whether "the [market dominant] system has achieved the [statutory] objectives applicable to that topic or sub-topic...." *Id.* The Commission's analysis also included consideration of relevant statutory factors and "any relevant additional considerations, including applicable statutory obligations...." *Id.* These analyses provided the bases for determining "whether the [market dominant] system, as a whole, has achieved the objectives of the PAEA." *Id.* at 22-23.

### B. The Commission's Findings Regarding the Financial Health of the Postal Service

Based upon its analysis of five subtopics identified in note 4, *supra*, the Commission found "that the [market dominant] system has not maintained the financial health of the Postal Service as intended by the PAEA." *Id.* at 249. That finding rests on three subsidiary findings. First, the Commission found that financial stability had not been maintained. *Id.* at 247. Second, it found that although incentives to achieve cost reductions and efficiency increases were achieved, those incentives were not maximized. *Id.* at 247-248. Third, it found that the market dominant system did not

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<sup>3</sup> *E.g.*, Order No. 4258 at 35 ("...the Commission relies upon its three-tier analysis detailed in Order No. 4257 as its starting point."); 40 ("The Commission uses Order No. 4257's medium-term stability framework for its analysis....").

<sup>4</sup> With respect to the structure of the ratemaking system, the Commission identified two subtopics: (1) the ratemaking process; and (2) pricing. *Id.* With respect to the Postal Service's financial health, the Commission identified five subtopics: (1) financial stability; (2) costs and operational efficiency; (3) reasonable rates; (4) mail security and terrorism; and (5) institutional cost allocation. *Id.* With respect to service, the Commission identified two subtopics: (1) service standards; and (2) service performance. *Id.*

maintain reasonable rates because products and classes failed to cover attributable costs and to cover both attributable and institutional costs as part of the Commission's medium term financial analysis. *Id.* at 248.

### III. ORDER NO. 4257 ERRONEOUSLY DETERMINED THAT SHORT-TERM FINANCIAL STABILITY HAS BEEN MAINTAINED

The Commission conducted its review of the Postal Service's financial stability (the first subtopic used to assess the Postal Service's financial health) on the basis of Objective 5. *Id.* at 151. The goal of Objective 5 is "[t]o assure adequate revenues, including retained earnings, to maintain financial stability." 39 U.S.C. § 3622(b)(5). The Commission's analysis of financial stability looked at "three tiers of financial stability to determine whether the Postal Service is financially solvent while able to respond to changes in its environment and meet its statutory obligations." *Id.* at 159. The Commission concluded that short-term financial stability has been achieved, but that medium-term and long-term financial stability have not been achieved. *Id.* at 247. Because not all three tiers of stability have been achieved,<sup>5</sup> the Commission found that the market dominant system had not achieved the goals of Objective 5: *See id.*

The Public Representative submits that the Commission erred in concluding that short-term financial stability has been achieved. This is a significant error. The Commission's finding that short-term financial stability has been maintained does not, of course, preclude its broader finding that the Postal Service's overall financial stability has not been achieved because of medium-term and long-term financial instability. The finding of short-term financial stability is nevertheless problematic because it is relied upon as a premise for the remedies proposed in Order No. 4258. Unless corrected, the incorrect finding of short-term financial stability will adversely affect the timing of the remedies needed to correct the deficiencies in the current market dominant system.

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<sup>5</sup> *Id.* at 159 ("The three tiers build upon each other, and in order for the Commission to find that the system has maintained financial stability, including retained earnings, throughout the PAEA era, the Postal Service must have achieved all three tiers of the financial stability metric.").

A. Order No. 4257 Fails to Provide an Adequate Justification for Its Treatment of RHBF Funding Requirements in the Short-Term Financial Stability Analysis

In responding to commenters who urged it to disregard the Postal Service's statutory obligations (e.g., the RHBF prefunding obligation, FERS supplemental contribution obligations, and the obligation to make adjustments to workers' compensation liability), the Commission correctly concluded that it was required to consider these obligations in the 10-year review. *Id.* at 157-159.

Notwithstanding its conclusion that statutory obligations must be considered in the 10-year review, the Commission concluded that "the current system has allowed the Postal Service to maintain short-term financial stability." *Id.* at 165. In doing so, the Commission fails to provide proper recognition to appropriate accounting standards and statutory obligations in its analyses of the Postal Service's short-term financial stability.

1. The Commission Has Failed to Justify the Reduction of Operating Expenses in Assessing Short-Term Financial Stability

Referring to Order No. 3673, the Commission begins by stating that it "measures short-term financial stability by analyzing the Postal Service's operating profit (*i.e.*, operating revenue – operating expenses)." <sup>6</sup> This is not, however, what the Commission has done. Instead, the Commission first calculates what it calls operating expenses "by reducing the Postal Service's total costs" reported in the Cost and Revenue Analysis (CRA) reports "by interest expense..., and the accruals for payments to the RHBF, non-cash workers' compensation, and supplemental contribution to the FERS annuity" reported in the Postal Service Form 10 K reports. <sup>7</sup> The result of the Commission's proposed adjustments to total costs is to produce, not "operating expenses", but "**net**

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<sup>6</sup> *Id.* at 159. See also Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products, December 20, 2016 at 7 (Order No. 3673).

<sup>7</sup> *Id.* at 160 n. 263. The Commission asserts that "[t]his approach is consistent with that taken in the Commission's annual financial reports" citing as an example its FY 2016 Financial Report at 6 n. 6. *Id.* See also Library Reference PRC-LR-RM2017-3-1, worksheet "Table II-6" which provides a more accurate list of the data sources than does footnote 263.

operating expenses.”<sup>8</sup> The term of “net operating expenses” is not the same as “operating expenses” proposed in Order No. 3673.<sup>9</sup>

This downward adjustment to the Postal Service’s expenses is substantial, and transforms the actual operating loss into an adjusted operating profit.<sup>10</sup> In other words, the consequence of using net operating expenses, as the Commission has done in Order No. 4257, is to create an operating profit that does not really exist.

While it is true, as the Commission asserts, that it has used the net operating expense concept in the Financial Reports that it issues annually, it did not do so to analyze short-term financial stability as it has done in Order No. 4257. Rather, the Commission has used the net operating expense concept in the annual Financial Reports in order “to provide an in-depth analysis of the financial results for FY 2016.” FY 2016 Financial Report at 5. In that regard, the Commission’s net operating expense concept is more akin to the Postal Service’s annual calculation of “controllable (loss) income” which provides insights into how the Postal Service has done containing costs within its control in the day-to-day operation of its business. See, e.g., FY 2017 Postal Service Form 10-K at 17. In presenting this calculation, the Postal Service candidly admits that controllable costs is a “non-GAAP” measure (*i.e.* an accounting principle not generally accepted in the United States) and that “[c]ontrollable (loss) income” should

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<sup>8</sup> This can, for example, be seen by reference to the Statements of Operations in the Postal Service’s FY 2016 Form 10-K. See FY 2016 Postal Service Form 10-K at 39, Statements of Operations, under the column heading 2016. The Statements of Operations shows operating revenue of \$71.429 billion, which is the same as the operating revenue provided in Table II-7 of Order No. 4257. *Id.* at 39; Order No. 4257 at 163. Likewise, the Statements of Operations shows the total operating expenses of \$76.899 billion and an interest expense (loss) from operations of \$0.222 billion, which, when combined, is equal to the \$77.121 billion of total costs shown on Table II-6 in Order No. 4257. In short, the “Total Costs” shown on Table II-6 are, in fact, total operating expenses plus interest expense as clearly seen from the Postal Service’s Form 10-K.

<sup>9</sup> See Order No. 3673 at 7. The proper characterization of this operating expense as a “net operating expense” is confirmed by footnote 6 in the Commission’s FY 2016 Financial Report as cited in footnote 263 of Order No. 4257. See FY 2016 Financial Report at 6 n. 6.

<sup>10</sup> For example, in Fiscal Year 2016, the adjustment exceeded \$7.4 billion. See Order No. 4357 at 161, Table II-6. By making this adjustment, the Commission transforms a loss of \$5.692 billion into an operating profit of \$1.792 billion. The adjusted operating profit is calculated by the Commission using \$71.429 billion of FY 2016 revenue shown under the column heading “Operating Revenue” in Table II-7 and the \$69.637 billion of FY 2016 expenses shown in that same table under the column heading “Operating Expenses”. *Id.* at 162.

not be considered a substitute for net (loss) income and other GAAP reporting measures. *Id.*

2. The Commission Has Erred by Relying Upon Inflated End-of-Year Cash Reserves in Assessing Short-Term Financial Stability

The Commission seeks to provide further support for its finding of short-term financial stability by considering end-of-year cash reserves. Order No. 1457 at 163-164. The rationale for including end-of-year cash reserves in the Commission's analysis is that end-of-year cash reserves provide further means for meeting short-term obligations. *Id.* at 163. The problem with this rationale is that the end-of-year cash reserves relied upon by the Commission are, as the Commission forthrightly acknowledges, due to the Postal Service's limitation of capital investment and nonpayment of the statutory RHBf payment obligations. *Id.* In other words, the Postal Service's ability to maintain a level of cash sufficient to maintain operations in the short-term is due to its ability to avoid meeting other obligations including statutory obligations in at least the short-term. This rationale sounds more like insolvency than short-term financial stability. Given the acknowledged source of the end-of-year cash reserves (inadequate investment and defaulted statutory obligations), the attempted reliance upon what can only be considered temporarily inflated end-of-year cash reserves is unjustified.

B. Order No. 4257 Relies, Without Justification, on Defaulted Legal Obligations and Inadequate Investment as a Basis for the Determination of Short-Term Financial Stability

The Commission's attempt to demonstrate short-term financial stability by either ignoring defaulted statutory obligations in the calculation of operating expenses or relying indirectly upon those defaults and the deferral of necessary investment is not justified. That attempt is in direct contradiction of one of the PAEA's central purposes, namely, that the Postal Service, like private commercial enterprises, operates in a

businesslike manner using best business practices.<sup>11</sup> It is axiomatic that private commercial enterprises do not, and cannot, claim short-term financial stability by defaulting on their obligations or by deferring investments that are critical to their near-term continued operation.

C Short-Term Financial Instability Indicates a More Immediate Need for Modification to the System Necessary to Achieve the Objectives of 39 U.S.C. § 3622(b).

If any doubt remained as to the short-term financial instability of the Postal Service, that doubt has been eliminated by the fact that on September 30, 2017, the Postal Service defaulted on its recalculated RHBF prefunding payment, its CSRS and FERS unfunded liability amortization payments, and, for the first time, on its RHB normal costs. FY 2017 Postal Service Form 10-K at 55. These defaults totaled \$6.9 billion. Fiscal Year 2018 Integrated Financial Plan at 4. Looking ahead to FY 2018, the Postal Service states that:

In 2018, our liquidity is projected to decrease to approximately \$4.8 billion if we pay all of the required amortization and normal cost payments for 2018 (not including past due payments from prior years). This equates to approximately 17 days of available liquidity.

*Id.*

The Postal Service is clearly facing short-term financial instability. As the Commission has acknowledged, the three-tiers of financial stability (short-term, medium-term, and long-term) build on each other. Order No. 4257 at 159. The Postal Service's short-term financial instability must, no less than its medium-term and long-term financial instability, be addressed promptly.

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<sup>11</sup> See H.R. Rep. No. 66, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2005) at 43; S. Rep. No. 318, 108<sup>th</sup> Cong., 2<sup>nd</sup> Sess. (2004) at 49; The Presidential Commission on the U.S. Postal Service, Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service, July 31, 2003, at 18, 21, 36.

#### IV. CONCLUSION

For the reasons set forth above, the Public Representative moves for reconsideration of Order No. 4257 and requests the Commission to find that Postal Service short-term financial stability has not been maintained.

Respectfully submitted,

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